



May 28, 1996

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
Room 222
1919 M Street, NW
Washington, D.C. 20554

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Re: In the Matter of: Allocation of Costs Associated with Local Exchange Carrier
Provision of Video Programming Services: CC Docket No. 96-112

Dear Mr. Caton,

Enclosed herewith are the original and twelve (12) copies of GVNW, Inc/Management's Comments in the above-captioned matter. Please acknowledge receipt by affixing an appropriate notation on the copy of the GVNW Comments furnished for such purpose and return in stamped addressed envelope provided. Courtesy and transcription copies have been provided.

Yours truly,


Robert C. Caprio
Manager
GVNW, Inc/Management

cc: Ernestine Creech, Accounting and Audits Division
ITS

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**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of

**Allocation of Costs Associated with
Local Exchange Carrier Provision of
Video Programming Services**

CC Docket No. 96-112

COMMENTS OF GVNW INC./MANAGEMENT

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SUMMARY

GVNW is a consulting firm representing small independent local exchange carriers (ILECs) from a number of states. Issues of major concern upon which we comment include the following:

a - Allocation rules must be established that will not result in such a high allocation of costs (primarily loop costs) to nonregulated services that rural ILECs will not be able to justify the provision of nonregulated services. Such services could very well jointly use facilities which are all necessary to offer basic telecommunications services. This could occur even if the facilities necessary to provide nonregulated services, such as video services, are in the local telephone company's telecommunications infrastructure used to furnish rural areas with universal telephone service and access to advanced telecommunications features and functions. Appropriate cost allocation methods are necessary to ensure a delicate balance is maintained between avoiding undue market power and technological deprivation in rural, non-competitive areas. The standards created in this docket must seek to maintain fairness in cost signals for market entry and enhance future competition by eliminating cross-subsidies and incorrect price signals without depriving rural areas access to nonregulated services. We recommend that any cost allocation factor adopted for loop investment include an element which is based on actual demand for both regulated and nonregulated services being provided.

b - We recommend that the allocation of switching costs and overheads continue to utilize existing allocation procedures. Part 64 rule have functioned effectively and can serve as a basic starting point for rules and standards

c - We also recommend that that spare facilities continue to be allocated based on the peak relative regulated and nonregulated use made of deployed plant. If changes are made as recommended to allocate costs based on the future possibility that facilities may be utilized for nonregulated services, ILECs will be faced with an extremely uncertain future regarding recovery of costs which, in order to provide universal telecommunications service as required by the 1996 Act, must be made

COMMENTS

GVNW Inc./Management (GVNW) is a management consulting firm representing small incumbent local exchange companies (ILECs). In response to the Commission's Notice of Proposed Rule Making (NPRM) in the above referenced docket, GVNW respectfully submits the following comments:

In this NPRM, the Commission will determine the appropriate methods and standards for allocating cost between regulated telephone services and nonregulated activities such as video programming, CPE sales and services, nonregulated high speed transport services, and other nonregulated business activities. Our primary concern is that if cost allocations to video programming services exceed a reasonable level, customers located in rural areas will not be afforded the opportunity to receive video programming, or some other advanced service from ILECs due to pricing distortions caused by cost allocations.

The NPRM recognizes that the 1996 Act "gives incumbent local exchange carriers broad flexibility in determining how to enter and compete in the video marketplace."¹ For ILECs serving rural, high cost areas, the flexibility to enter the video marketplace granted by the 1996 Act will not result in economically feasible video programming market entry decisions if required cost allocations make the provision of the contemplated service uneconomical due to the assignment of high costs of the underlying investment. In rural

¹ CC Docket 96-112, NPRM at Para. 4.

areas, this will certainly not serve the language contained in the 1996 Act that “vigorously competitive markets are the best way to serve consumers interests.”²

In many rural areas, high quality telephone services are afforded to the customer base only from, and as a direct result of, the operation of high cost support mechanisms. The recognition of these mechanisms in rural areas will require a careful balancing of interests when defining cost allocations for such high cost companies.

We are also concerned that requiring fully allocated cost procedures by ILECs attempting to compete with, for example, other cable operators will put the ILECs at a competitive disadvantage. Cable operators now have the ability to offer telecommunications services over their existing networks and have no similar cost allocation requirements. ILECs often are well situated to provide competition and introduce new services in their market areas. The allocation rules must be made flexible enough to recognize differences in markets and companies, yet rigid enough to ensure stability and competitive equity. As with all regulatory policy tools, the rules will serve to incent and/or possibly disincent ILECs to enter new nonregulated businesses, while at the same time provide nonregulated pricing signals to other service providers. Ultimately, these rules will have a direct impact on the availability of new services and technologies to consumers.

² *Id.* at Para. 4

Allocation of Loop Costs

Because of the high cost of providing telephone service in rural areas, the Commission has established a Universal Service Fund to assist with the high loop cost incurred by ILECs. The availability of the Fund has encouraged ILECs to make investments which, if recovery was dependent solely on charges to end users, would not have been made. This difficult reality of the cost of providing universal telephone service to rural areas must not be permitted to adversely affect the availability of other services and technologies to the supported customers. The cost allocation rules could serve to make available competitive services and technologies at prices which are not anti-competitive and yet contribute toward recovery of a portion of the costs necessary to provide universal telephone service.

The use of a gross allocator to assign loop costs between regulated telephone service and video programming, or some other nonregulated service, would result in a uneconomical assignment of costs to nonregulated since the existing and future loop costs necessary to provide universal telephone service will continue to be high.³ ILECs develop their networks for the primary purpose of delivering universal telephone service. For example, the standards and reliability expectations are clearly higher in telephony than in the CATV industry. The added cost to achieve the expectations for telephone service would likely result in "per comparable unit cost" (however defined) which is higher for provision of telephone service than CATV service. The provision of universal service results in higher loop costs for the provision of telephony than would be undertaken if the

³ Based on 1994 data, NECA has determined that the average nationwide loop cost is \$248.29. Many ILECs have loop costs several times this amount

investment decision were only for the provision of a combination of telephone service and video programming in more urban, lower cost areas

Without the mandate to provide universal telephone service and the availability of “sufficient and predictable”⁴ universal service funds, investments suitable and/or compatible for providing video programming, or other advanced service, might not be made by any service provider in very high cost areas. The likely candidate for bringing such services to very high cost areas is the ILEC. Cost allocation standards should not serve to discourage such investments. With high cost allocations to video programming, many rural ILECs may find it necessary to forego the provision of video programming since the costs assigned to video would make the provision of service too costly to be offered. This is possible in circumstances where a compatible platform of facility investment resides in the ILEC network today. The decision to not make an incremental investment in some compatible equipment is made because providing the service will pull too much cost to the nonregulated service. Such a decision does not benefit or serve the public interest and would not reduce ILEC dependence on the Universal Service Fund.

We agree that costs allocated to each individual service or subset of services should be less than the stand-alone cost but greater than the incremental cost.⁵ This can and should be accomplished without mandating a flat gross allocator which allocates substantial costs necessary to provide universal telephone service to nonregulated video programming. A system must be designed that will allow the ILEC to enter the video

⁴ Telecommunications Act of 1996, Para. 254(b)(5)

⁵ CC Docket 96-112, NPRM at Para. 20.

programming market while reducing its dependence on implicit subsidies for the provision of telephone service. The NPRM suggests that one alternative would be to establish a ceiling on total loop costs that an ILEC may allocate to regulated activities.⁶ We propose a similar, but opposite ceiling. We recommend that, if a gross allocator is utilized for the allocation of loop plant, that it only be applied to an ILECs cost up to the national average as computed by NECA for the purpose of determining universal service funding. The remaining cost would be appropriately assigned to the provision of universal telephone service. In this way, an ILEC serving a high cost area would be able to bring competitive choices to its serving territory while also reducing its dependence on implicit subsidy mechanisms through a cost allocation “contribution” made by the nonregulated entity. We oppose any plan which would establish a ceiling on total loop costs that an ILEC would be allowed to assign to regulated activities. Such a decision would not provide the appropriate economic signals necessary to provide universal telephone service to all areas of the country at reasonable and affordable rates as mandated by the 1996 Act and would severely limit the ability of ILECs to offer nonregulated services competitively, or at all.

In establishing a specific allocation factor, we feel that some recognition of the market penetration by each service being offered should be reflected in the allocation. With telephone penetration exceeding 90% in most areas of the country, and CATV at a substantially lower level, recognition of penetration levels would yield a more reasonable result. It is possible that many ILEC video programming services would not be available throughout the telephone serving area.

⁶ CC Docket 96-112, Para. 35.

We disagree with the tentative conclusion “that relative demand cannot form the basis for allocating common loop costs between regulated and nonregulated services.”⁷ We recommend that, if a gross allocator is adopted, the allocation be weighted based on a count of subscribers or potential subscribers for each service. Again, recognition of special circumstances and market conditions could lead to optimization of the balance between competitive fairness, affordability, and customer needs.

Allocation of Switching Costs

The allocation of switching costs should continue to be based on relative usage. This procedure is appropriate for those facilities which can be measured and for which usage bears a relationship to incurred costs. We recognize the dynamic nature of technology and the related new services that are emerging. Investment decisions must weigh more than simply “what’s the latest and greatest” Switch investment decisions necessarily depend on cost recovery, service capability, asset life, and the like. The cost allocation rules for switching investments must not serve to handicap ILECs ability to create services and maximize the use of the asset. Current Part 64 procedures for allocating these costs for rate of return regulated companies continue to effectively handle this requirement.

⁷ CC Docket 96-112, Para. 41

Allocation of Overheads

We recommend that the current rules contained in Part 64 of the rules and employed by ILECs for the allocation of overheads are reasonable and consistent with the stated goals. The Commission's rules, in place to protect ratepayers from cost and risks associated with nonregulated activities, have governed ILECs in the allocation of joint and common costs. The nature of the overhead costs have not changed, and we recognize that all methods for allocating common overheads are at their root arbitrary. For small ILECs the current Commission rules are effective. The current Part 64 procedures for allocating common overheads should be retained.

Allocation of Spare Facilities

Spare facilities are a fundamental feature of modern telecommunications plant planning. Planning for spare facilities serves to ensure that short term facility requirements will be met with current technology. Creating any allocation of cost of spare facilities based on non representative market or demand data is unfair and would provide disincentive for nonregulated investment.

Allowing spare facilities to continue being allocated based upon the peak relative regulated and nonregulated use made of deployed plant is a reasonable method of allocating spare facilities and should be continued. This method ensures that an appropriate portion of spare facilities is allocated to all services being offered which utilize the facilities. To make the assumption that spare usage is more likely to be utilized in the future for the provision of services which "may" be nonregulated, and therefore, increase

the allocation of spare facilities to nonregulated services defeats the basic purpose of establishing cost allocation rules.

Rules must be established which allocate costs based on the best information available at the time regarding the actual use made of the facilities. Any movement away from this proven methodology will result in revenue streams which are not “predictable” as required by the 1996 Act.⁸ Such a modification could result in an ILEC that invests in new technology which may be necessary to bring advanced telecommunications features and functions to its serving territory finding that a significant portion of the spare facilities are assigned to nonregulated. This could occur even if the ILEC had no plans to enter a nonregulated business. Such a result would be disastrous for rural ILECs and their customers as the uncertainty associated with future cost recovery would greatly inhibit investment in state of the art infrastructure.

Pole Attachment and Conduit

The Act is clear in its intent to foster and promote competition as the means by which customer needs and technology deployment goals are met. The use of pole attachments, conduit, rights of way and like costs of doing business in telecommunications have offered ways to introduce new competitors alternatives for entry into service areas which might have been impossible to enter were it not for these arrangements. The imputation issue has long been discussed in pricing for competitive services. We feel that for contribution purposes, pole attachments and like revenues should reduce the regulated

⁸ Telecommunications Act of 1996, Para. 254(b)(5).

expenses associated with the asset. This method would serve the regulated customer's interests by lowering their cost of poles and other like assets contained in the regulated rates.

CONCLUSION

The advancement and promotion of competition is the overriding theme in telecommunications policy today. The tools of the regulatory framework defined in this docket will hold in balance the competing interests of nonregulated competitors, ILECs, and others. The purpose of the cost allocation procedures is to continue to protect captive ratepayers from illegal cross-subsidy and abuse of market power. The FCC must consider the differing circumstances and market conditions faced by ILECs and craft cost allocation rules that serve the ratepayers and promote competition in the industry.

Cost allocation rules must be flexible recognizing the market forces, condition, and customers of different ILECs. One size will not fit all for prescribing the cost allocation rules.

Current Part 64 procedures should provide a base for new procedures. Part 64 has performed the cost allocation functions that are being explored in this docket and the industry's experience with Part 64 and the fact that the nature of some costs (overheads) has not changed, most portions of the Part 64 rules should continue to operate.

We recommend that, if a gross allocator is utilized for the allocation of loop plant, that it only be applied to an ILECs cost up to the national average. The remaining cost would appropriately be assigned to the provision of universal telephone service. In this way, an ILEC serving high cost areas would be able to bring competitive choices to its serving territory while reducing its dependence on implicit subsidies through a "cost allocation contribution" made by the nonregulated entity.

The overall goal of promoting competition does not unfortunately, change the basic nature of the telecommunications markets served by many of the ILECs. Competition in some markets will develop very slowly, and thus take longer to bring advanced services and investments in technology to those areas. The cost allocation rules promulgated under this proceeding must recognize that these differing conditions exist and provide the means by which ILECs can continue to provide and promote state-of-the-art services to customers at reasonable and/or competitive rates.

Respectfully submitted,

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